

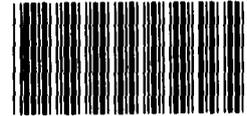
UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

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STATEMENT OF
WILLIAM J. ANDERSON, DIRECTOR
GENERAL GOVERNMENT DIVISION
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
HOUSE COMMITTEE ON WAYS AND MEANS
CONCERNING IRS POLICIES AND PROCEDURES
TO SAFEGUARD TAXPAYER RIGHTS AND
THE EFFECTS OF CERTAIN PROVISIONS
OF THE 1976 TAX REFORM ACT



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Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to assist the subcommittee in its inquiries concerning how IRS safeguards taxpayer rights and its inquiries about the effects of the summons and the return preparer penalty provisions of the 1976 Tax Reform Act. Much of our testimony is based on our past reviews of IRS activities. We have supplemented that data with a recent limited review of IRS' current policies, procedures, and controls for safeguarding taxpayer rights and dealing with related alleged violations.

Mr. Chairman, the main point I would like to make today is that while there may be instances where IRS has violated a taxpayer's rights, we have found no evidence to indicate that such

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instances are widespread or systemic. During fiscal year 1981, IRS had about 49 million personal contacts with taxpayers through its tax administration activities of providing assistance, examining returns, collecting delinquent taxes, locating taxpayers who do not file returns, investigating possible criminal violations, and hearing taxpayers' appeals. Given this number of personal contacts, the odds are that some taxpayers' treatment was less than correct. However, we cannot estimate the number of instances where this might have occurred. By the same token, there is no measure of overall taxpayer satisfaction with the treatment received from IRS.

To obtain such a measure there are at least two approaches which merit consideration. First, IRS could survey a statistical sample of taxpayers to determine their level of satisfaction with IRS' treatment. In this regard, there are three bills 1/ presently pending in the Congress which would require IRS to survey taxpayers to obtain their evaluation of the quality of IRS' service. Second, IRS could expand the statistical information system in its Problem Resolution Office to include all complaints dealing with alleged violations of taxpayer rights and the validity and resolution of those complaints. If the subcommittee, on the basis of these hearings, wishes to pursue this further, it could ask IRS to develop cost/benefit data on the feasibility of these approaches.

1/H.R. 464, H.R. 3540, and S. 850.

I would now like to discuss IRS' management control system for safeguarding taxpayer rights and, later, our observations on the two provisions of the 1976 Tax Reform Act.

SAFEGUARDING TAXPAYER RIGHTS

Collecting taxes is one of the most unpopular functions of the United States Government. This unpopularity is perpetuated by adverse news articles and uncomplimentary cartoons and jokes about the Internal Revenue Service. Add to this the frustration many of us recently faced as we gathered the information necessary to file our tax returns, and it is apparent why many have a negative image of IRS.

How much of this characterization is justified? It seems reasonable to assume that given the number of people involved in tax administration activities, some abuses of taxpayer rights will occur. Some instances of abuse have, in fact, been documented by both IRS and the media. However, during our many reviews, which have covered most of IRS' major programs and activities, we have not found any flagrant abuses of taxpayer rights, nor have we found any indication of systematic attempts to violate such rights. We attribute this in large part to the design of IRS' management control system for safeguarding taxpayer rights.

We recently made a limited review of that system and found that it appears to provide reasonable safeguards. The system includes policies, procedures, and controls designed to prevent,

detect, and resolve abuses of taxpayer rights. We approached our evaluation task from a systems perspective rather than attempting to evaluate specifically how well each of those policies, procedures, and controls work. We determined that those aspects of the system designed to prevent abuses should, if properly implemented, minimize the number of instances where taxpayer rights are violated. From this same perspective, we also determined that those aspects of the system for detecting and resolving alleged and actual abuses of rights seem to be producing acceptable results. These observations are reassuring given the potential for violations of rights that could occur if IRS' management control system did not work.

An overview of the problem

IRS has awesome powers to carry out its tax collection responsibilities. To determine that taxpayers pay the correct amount of tax, IRS can require taxpayers to produce records to substantiate amounts shown on their tax returns. If they refuse, IRS can summon the records and/or recompute the taxes by disallowing unsupported claims. If taxpayers do not pay their assessed taxes within 10 days after notice and demand for payment, IRS can seize their property. These powers can affect the financial well-being and personal lives of almost every taxpayer.

To protect taxpayers from potential abuse of these powers, many laws have been enacted and procedures established giving taxpayers certain rights. Examples of such laws and procedures are those which give the taxpayer the right to appeal an IRS

agent's proposal to a higher authority within IRS or to the courts; those which limit IRS' time to audit a tax return to 3 years after the return is filed; and those which require IRS to notify a taxpayer before levy or seizure of his or her property can take place. These laws and procedures are fairly specific and violations can be easily identified.

However, procedures to protect taxpayers from intimidation or harassment by overzealous IRS employees cannot be equally as specific and, as a result, incidents of such treatment cannot be as easily identified. Many times an IRS employee must rely on his or her individual judgment when dealing with a taxpayer. Whenever individual judgment is involved, there is a chance that the employee may act improperly and, contrary to policy, violate a taxpayer's rights.

It would be difficult, if not impossible, for any organization as large as IRS, with about 85,000 employees, to assure proper conduct by all its employees all the time. Therefore, it is extremely important that IRS have systems to detect and resolve such incidents when they do occur.

Prior GAO work

We have reviewed most of IRS' major programs and activities over the past several years. In most cases, our reviews of specific IRS procedures and practices have dealt in some way with IRS safeguards of taxpayer rights and have led to related improvements. I would now like to illustrate that point by briefly summarizing a few examples of our past work. The first three reports

I will discuss deal with IRS' collection activities, and the last four deal with IRS' examination activities.

In November 1981 we issued a report on how IRS deals with taxpayers who claim they cannot immediately fully pay their taxes. 1/ Contrary to much of the publicity on IRS' alleged overzealous or inappropriate use of its strong collection powers, we found that the agency was not always taking enough action to collect delinquent taxes. Our review of collection actions taken against 1,500 taxpayers in four IRS districts showed that IRS was allowing taxpayers to delay or possibly avoid paying their taxes even though more stringent collection actions could and should have been taken. One of the reasons for IRS' lenient approach to collections was its concern about congressional and public criticism.

We pointed out in the report that IRS should obtain accurate and reliable taxpayer financial information to determine appropriate collection action. With this information, not only would IRS be able to collect more taxes, but it also would be in a better position to determine if and when it needed to use stronger collection tools such as levies and seizures. We believe that the more information IRS has about an individual taxpayer's financial condition, the more likely IRS will be to consider both the Government's and the taxpayer's interest in taking the proper collection action.

In July 1978, we issued another report specifically addressing IRS' procedures and practices for seizing and disposing of

1/"What IRS Can Do To Collect More Delinquent Taxes" (GGD-82-4, Nov. 5, 1981).

taxpayer property. 1/ We found that taxpayers were generally treated fairly, but we did note two problem areas where IRS has since taken action to improve the safeguarding of taxpayer rights. IRS needed to inform taxpayers of their appeal rights and to assure that fair prices are sought from the sale of seized property. During our review, IRS developed a publication discussing taxpayers' appeal rights and also developed procedures to routinely provide this publication to delinquent taxpayers. In addition, IRS revised its procedures for setting the minimum sale price and for allowing taxpayers to request an independent appraisal in order to establish the minimum acceptable price for seized property. This gives taxpayers better assurance that their equity in the property will be protected.

Our July 1976 report on jeopardy and termination assessments noted that IRS could sell property seized from taxpayers owing certain taxes, such as employment and excise taxes, before the taxpayer had the opportunity to contest the tax liability in court. 2/ The Congress amended the Internal Revenue Code, through the Tax Reform Act of 1976, to allow time for taxpayers subject to these taxes to petition the district court before seized property is sold.

Other examples I would like to mention come from four of our reports relating to IRS' Examination Division. Our March

1/"IRS Seizure Of Taxpayer Property: Effective, But Not Uniformly Applied" (GGD 78-42, July 31, 1978).

2/"Use of Jeopardy And Termination Assessments By The Internal Revenue Service" (GGD-76-14, July 16, 1976).

1977 report on IRS' use of waivers to extend the statutory 3-year period for audit and assessment 1/ noted that IRS was not routinely giving taxpayers the information needed for them to make informed decisions about signing such waivers. We estimated that waivers were used in only 2 percent of the 50,000 audits closed in three IRS districts during our sample period. However, when waivers were used taxpayers were not always made aware of the options available to them or of the consequences of these options. Since our review, IRS has developed a pamphlet explaining what rights and options taxpayers have if requested to sign a waiver of the statutory assessment period. Procedures call for this pamphlet to be provided to the taxpayer with the waiver request.

In November 1976 and again in November 1977 we reported on IRS' selection of individual income tax returns for audit based on our respective reviews of random samples of 1,500 audited taxpayers 2/ and 1,200 taxpayers whom IRS audited repetitively. 3/ We concluded that IRS' procedures for selecting returns for audit generally protect taxpayers against abuse.

Most tax returns are selected for audit on the basis of a mathematical formula. However, in some cases returns can be requested manually based on a relationship to another audited return

1/"Extending the Tax Assessment Period: Why, How Often, and What Improvements Can Be Made" (GGD 76-108, Mar. 28, 1977).

2/"How The Internal Revenue Service Selects Individual Income Tax Returns For Audit" (GGD-76-55, Nov. 5, 1976).

3/"Repetitive IRS Audits Of Taxpayers Are Justified" (GGD 77-74, Nov. 18, 1977).

or an area involving a specific tax issue. In regard to the manual requests, we noted that IRS needed to ensure that its employees adequately justified obtaining tax returns. IRS has redefined some of the justifications for employee-selected tax returns and requires supervisory approval before the returns are audited.

At the request of this subcommittee, we also investigated allegations that IRS harassed 28 Mississippi civil rights activists through extensive audits of their tax returns. 1/ We found no evidence of any organized effort or intent by IRS to harass these taxpayers.

IRS policies and procedures
for preventing abuses of
taxpayer rights

IRS' management control system recognizes that the first step toward protecting taxpayer rights is to prevent abuse. To this end, the system includes operating policies and procedures which set the tone for the agency's dealings with taxpayers and which establish internal and external controls for each operating element to assure that policies and procedures are being followed.

I will now describe for you some examples of how IRS' management control system to prevent abuses of taxpayer rights is implemented in the Examination, Collection, and the Criminal Investigation Divisions.

1/"Allegations That IRS Harassed Mississippi Civil Rights Activists Unsupported" (GGD 78-32, Jan. 27, 1978).

Examination Division

In examining returns IRS attempts to correctly apply the tax laws enacted by the Congress, to determine the reasonable meaning of various code provisions, and to perform audits in a fair and impartial manner with neither a Government nor a taxpayer point of view. 1/ In this regard there are a number of laws and IRS procedures to help safeguard taxpayer rights. Some examples follow.

By law taxpayers are required to produce records to substantiate amounts shown on their tax returns whenever IRS requests them. 2/ However, taxpayers have the right to expect that the time and place of the examination be reasonable. 3/ When IRS decides to examine a particular return, IRS notifies the taxpayer in advance of the time and place of audit. Also, IRS notifies the taxpayer in writing or verbally of what items on the return are being examined and/or what records need to be furnished. Should the taxpayer be unable to keep the scheduled appointment, IRS will usually work out another date or place convenient to the taxpayer. 4/

1/Revenue Procedure 64-22, 1964-1 (Part 1) Cumulative Bulletin 689.

2/Internal Revenue Code sections 6001 and 7602.

3/Internal Revenue Code section 7605 and Internal Revenue Manual sections 4261.2(1) and 4252(3)(b).

4/Internal Revenue Manual sections 4253.4 (1)(a) and 4261.2(2) and IRS form letters 889(DO), 890(DO), and 904(DO).

Taxpayers also have the right to have someone accompany them or represent them at the examination. 1/ Should taxpayers elect to have representation, IRS requires that the taxpayers give their representatives power-of-attorney covering the particular return(s) under examination. This requirement exists to protect against unauthorized disclosures of tax return information. 2/

Sometimes, taxpayers do not show up for the examination and/or do not produce all the necessary records. According to IRS officials, after additional requests to appear and/or produce the records do not provide results, IRS has two alternatives. First, if an expense item is questioned, IRS may disallow unsubstantiated amounts and recompute the tax. Or, if IRS cannot determine the additional tax, it may summon the records. 3/ When a summons is issued to a taxpayer or a third party and it is not complied with, a district court must rule on the enforceability of the summons. 4/ I will briefly discuss the administrative summons procedures for records held by a third party later in this testimony.

In most instances, taxpayers turn over the records necessary to complete the audit without the need for a summons. Proposed tax liability changes resulting from the audit are discussed

1/Title 5 U.S. Code, section 555(b) and Internal Revenue Manual section 4055.21(2).

2/Internal Revenue Manual sections 4055.21(1),(2), and (3).

3/Internal Revenue Manual section 4022.3(8).

4/Internal Revenue Code section 7604(b).

with the taxpayer. In these cases, IRS procedures require that the taxpayer be informed about why the change is being proposed and that he or she can appeal the examiner's findings within IRS or to the courts. 1/ If the taxpayer and IRS cannot agree, a formal notification of the proposed tax change is sent to the taxpayer. 2/ This notification informs the taxpayer that he or she has 90 days to appeal to the Tax Court for a review of IRS' findings. 3/

Collection Division

In collecting taxes IRS attempts to be fair and impartial. IRS has several policies, procedures and controls in place to accomplish this. I would like to focus on IRS' procedures for using levies and seizures because these tools can have the most substantial impact on the taxpayer.

Levy refers to IRS' seizure of a taxpayer's assets in the possession of third parties, such as bank accounts and wages. Seizure refers to IRS' seizure of a taxpayer's assets in his or her own possession such as an automobile, business equipment, or building. During fiscal year 1981, IRS, in disposing of 2.2 million delinquent accounts, used its levy power about 740,000 times and its seizure power about 8,800 times. As shown in the following table, IRS' use of levies and seizures has fluctuated

1/Internal Revenue Manual section 424(12).1.

2/Internal Revenue Manual section 8(11)34.

3/Internal Revenue Code section 6213.

over the past few years to a low in fiscal year 1978. Currently, the number of seizures made by IRS is about half of the numbers made in fiscal years 1975 and 1976.

DELINQUENT ACCOUNTS CLOSED
AND LEVY AND SEIZURE ACTIONS
FROM 1975 TO 1981

<u>Fiscal year</u>	<u>Number of delinquent accounts closed in district offices</u>	<u>Number of levies served</u>	<u>Number of seizures made</u>
1975	2,543,869	660,039	19,864
1976	2,384,399	622,080	16,413
1977	1,976,310	520,236	5,875
1978	2,012,513	444,912	5,104
1979	2,148,972	465,029	5,723
1980	2,247,534	610,942	9,421
1981	2,173,494	740,103	8,848

Note: For this comparison we did not include the 1976 transition quarter.

IRS can levy or seize a delinquent taxpayer's property if assessed taxes are not paid within 10 days after notice and demand for payment. 1/ However, IRS procedures are designed to give the taxpayer a reasonable chance to voluntarily settle a tax liability before these more drastic enforcement actions are started. 2/ First, an IRS service center normally sends four notices to an individual taxpayer (three to businesses) over a 3-month period. 3/ After this, the account is sent to a district office where further attempts are made to contact the taxpayer.

1/Internal Revenue Code section 6331.

2/Internal Revenue Manual section 5311(3).

3/Internal Revenue Manual section 5(18)13.22(1) and Exhibit 5(18)00-1.

Publications explaining the collection process and what the taxpayer should do if he or she disagrees with IRS' demands are automatically mailed to the taxpayer along with the second tax delinquency notice. 1/

IRS informs the taxpayer in the final normal mailing notice that if payment is not received within 10 days or if the taxpayer does not contact an IRS office, enforced collection--levy or seizure--may be taken. While some levy actions may be taken without further contact with taxpayers, 2/ IRS usually attempts to contact the taxpayers by telephone, field visits, or further correspondence to work out alternative ways to pay the tax delinquency before it levies taxpayers' salaries or wages or seizes their property. 3/ Also, when seizures are considered, procedures require IRS to attempt to notify the taxpayers in person that seizure will be the next action taken by IRS. 4/

IRS has established more controls over the use of seizures than levies. Generally, IRS does not require written supervisory approval before levy; however, before seizures are made IRS requires written approval by at least a group manager. 5/ Also, once seizure action is initiated, the cases are controlled and reviewed for procedural compliance by a special procedures staff within the Collection Division. 6/ Before revenue officers can

1/Internal Revenue Manual sections 515(14).2(2) and 515(15).2(2).

2/Internal Revenue Manual section 5311(6).

3/Internal Revenue Manual section 5311(3).

4/Internal Revenue Manual section 5341.1(2).

5/Internal Revenue Manual section 5341.1(5).

6/Internal Revenue Manual section 5341.3(5).

enter private premises, they must have either the written permission of the taxpayer or a writ of entry from a district court.1/ Also, in every case, the revenue officer must determine prior to seizing property that the taxpayer has sufficient equity in the property to apply against the tax liability.2/

In addition to the IRS employee making the seizure, another IRS employee or a law enforcement officer must be present when a seizure is made. This provides a witness to the propriety of the action. 3/ Further, the taxpayer is asked to be present when the seized property is inventoried. 4/

We have not recently tested the effectiveness of these controls but both our prior review of IRS seizures 5/ and a recent IRS internal audit indicate that these controls were generally operating effectively at those times.

Criminal Investigation Division

In enforcing the criminal provisions of the tax laws IRS attempts to identify and investigate suspected criminal violations and recommend any warranted civil and criminal sanctions. The most frequently prosecuted violations of these provisions are willful attempts to evade tax and failure to file tax returns. IRS' Criminal Investigation Division receives information on

1/Internal Revenue Manual section 5342.1(1).

2/Internal Revenue Manual section 5341.2(1).

3/Internal Revenue Manual section 5341.1(11) and (12).

4/Internal Revenue Manual section 5341.1(14).

5/"IRS Seizure Of Taxpayer Property: Effective, But Not Uniformly Applied" (GGD-78-42, July 31, 1978).

potential tax fraud from three basic sources--referrals from IRS' Examination and Collection Divisions, its own information gathering efforts, and information leads from other individuals and organizations.

Because Examination and Collection Division employees are involved in auditing tax returns, locating persons who do not file tax returns, and collecting delinquent taxes, they are in a unique position to spot indications of fraud. Their referrals and case records generally provide Criminal Investigation Division special agents enough information to determine if a detailed investigation should be initiated. Special agents augment this information referral program by obtaining information from other sources such as their own information gathering activities and leads from others--information items.

An information item is a tax-related communication received by IRS alleging or indicating that a particular individual or business may have violated a tax law. IRS receives many of these communications from varied sources, such as other Federal agencies, the general public, informants, and other IRS employees. These items are first screened at IRS' 10 service centers to determine their potential for a tax law violation and those having such potential are sent to the districts for further evaluation by special agents.

Some alleged and actual abuses of IRS' investigative authorities during the early 1970s led to improved management controls over information gathering activities in 1975. We reported on

IRS' case development and selection activities in November 1979.^{1/} We pointed out that the information gathering guidelines IRS issued in 1975 improved its controls over these activities but more needed to be done. We found that management controls needed to be strengthened over information gathering on individuals and that the justifications for investigating groups needed to provide more information on the proposed scope of the investigation and more fully and specifically indicate the groups' alleged noncompliance.

In December 1979, IRS revised its guidelines for information gathering activities to include more specific information on the scope of these activities and required that authorization requests have sufficient information to enable the authorizing official to determine whether the project is justified.^{2/} Specific written authorization is required before special agents can initiate information gathering efforts designed to determine whether a particular individual, business, or group has violated a tax law. The District's Criminal Investigation Division Chief must approve requests in writing to investigate individuals and the request must specify the known or assumed name of the taxpayer and the reason the information gathering should be authorized.^{3/} Investigations of groups of taxpayers must be approved in writing

^{1/}"Improved Planning For Developing And Selecting IRS Criminal Tax Cases Can Strengthen Enforcement Of Federal Tax Laws" (GGD-80-9, Nov. 6, 1979).

^{2/}Internal Revenue Manual Transmittal 9-134.

^{3/}Internal Revenue Manual sections 9391.71(2) and 9391.61(1).

by a District Director or a higher level IRS official. The authorization must state the investigation purpose, define the scope, and specify the estimated length of the effort and the type of information to be gathered. 1/

A March 1982 IRS internal audit report followed up on our November 1979 report. The report stated that compliance with the recommendations of our report was generally adequate but further refinements were needed to ensure that authorizations for information gathering projects include indications of noncompliance. In response to the internal audit report, IRS agreed to revise its guidelines to include indications of noncompliance as a criteria for authorizing information gathering projects.

IRS training programs

The procedures that I have just discussed are designed to protect taxpayer rights. However, they will be effective only to the degree that IRS employees have the knowledge and ability to carry them out. In this respect IRS has an extensive training program, offering over 500 courses in fiscal year 1981.

The amount of required classroom training is substantial. For example, according to IRS officials, during their first 5 years with IRS, Examination Division revenue agents receive about 24 weeks and Collection Division revenue officers receive about 12 weeks of training. In January 1982, the training for Criminal

1/Internal Revenue Manual sections 9391.61(1) and (2).

Investigation Division special agents was redesigned and increased from 17 to 30 weeks of classroom training during these employees' first 5 years with the agency. In addition to the classroom training, IRS employees receive structured on-the-job training. IRS also has a program for continuing professional education.

IRS officials stated that safeguarding taxpayer rights is an integral part of most IRS activities. Therefore, instead of providing a specific training course on the subject, points on safeguarding taxpayer rights are included where needed in all training programs. For example, in the Collection Division revenue officers' initial 7-week training program, one section deals with safeguarding taxpayer rights and, in addition to listing examples of those rights, stresses that taxpayers should receive prompt, courteous, and impartial treatment. The training also teaches that, when dealing with taxpayers, revenue officers should empathize with the taxpayer and initially assume that the taxpayer wants to comply.

Internal and external controls

Devising policies, procedures, and training is not enough. Management must also have information on how well the system is actually safeguarding taxpayer rights. Recognizing this, IRS, as part of its overall management control system, has devised controls both internal and external to its operating divisions to assure that policies and procedures are being properly implemented and are providing adequate protection of taxpayer rights.

One example of a primary internal control is supervisory review of work performed by subordinates. In the Collection Division, group managers provide the first-line supervision of collection activities and employees. 1/ Each collection case is assigned to different graded IRS employees on the basis of case difficulty. 2/ Group managers receive monthly listings of cases to assist them in controlling and reviewing their groups' workload. 3/ In addition, IRS procedures require group managers to review and analyze case files as well as to accompany collection employees on field visits and observe office interviews. 4/ The reviews and analyses may be unannounced and can take place as often as the group manager feels is necessary. 5/ The objectives of these reviews and field visits are to assure that revenue officers are following IRS policies and procedures and to help revenue officers improve their collection techniques. 6/

External controls include post reviews and internal audits. IRS regional offices periodically review districts' activities. During these reviews the regional offices have evaluated the districts' use of such tools as levies and seizures, including the appropriateness of that use. According to regional officials

1/Internal Revenue Manual sections 5184.3(1) and 5185(1).

2/Internal Revenue Manual sections 5184.1, 5184.2, and 5184.3.

3/Internal Revenue Manual section 5186.1(1) and (2).

4/Internal Revenue Manual sections 5184.3(2) and 5185(3).

5/Internal Revenue Manual section 5185(1).

6/Internal Revenue Manual section 5185(5).

in the Collection, Examination, and Criminal Investigation Divisions, the regional offices review all district activities including how well district employees safeguard taxpayer rights.

In addition, IRS' Internal Audit Division reviews management controls to ensure that they are adequate and operating properly so that taxpayers are treated fairly and equitably. These independent reviews include periodic testing and reporting on the effectiveness of internal controls to prevent, detect, and deal with IRS abuse of authority or violations of taxpayer rights.

Internal Audit officials identified for us 20 audits, conducted during fiscal years 1980 and 1981, that addressed issues directly impacting on taxpayer rights. Our review showed that these audits covered various facets of IRS operations including management controls to avoid unnecessary repetitive audits, service centers' responsiveness to taxpayer complaints, and the propriety of enforced collection actions. The internal audit of enforced collection actions was concerned with the recent increasing use of, and alleged abuses involving, liens, levies, and seizures and the impact of these actions on small business taxpayers. Internal Audit evaluated 840 randomly selected business tax delinquency collection actions and concluded that these enforced actions were warranted and that reasonable opportunity was given the taxpayers to pay their taxes voluntarily.

How IRS detects and deals with
alleged abuses of taxpayer rights

Regardless of how many controls exist to prevent violations of taxpayer rights, there will still be abuses--either

real or perceived. Recognizing this, IRS' overall management control system for safeguarding taxpayer rights includes controls for detecting and dealing with such violations.

The existing controls, in part, rely on taxpayers to complain if they feel they were treated improperly. In addition, IRS has Internal Audit and Internal Security programs to identify specific incidents of taxpayer abuse. Also, IRS employees are instructed to report misconduct of fellow employees to Internal Security.

Once alleged violations are detected, IRS has established several procedures for dealing with these incidents. Normally the allegations are initially handled by the operating divisions. If an allegation is not resolved at this level, it can be referred to the Problem Resolution Office. Serious misconduct cases are immediately referred to Internal Security and bypass the above procedures.

Although controls exist to detect and deal with violations of taxpayer rights, IRS does not know how many such violations occur. There are no mechanisms in place for capturing statistical data on the problems handled within the operating divisions. Statistical information is developed by the Problem Resolution Office but that information reflects only those complaints with which the Problem Resolution Office becomes involved.

Detecting alleged abuses

Taxpayers learn about the complaint system in many ways. IRS tells taxpayers both verbally and in publications that they should inform an IRS employee's supervisor of any actions the

employee proposes or takes that the taxpayer objects to. Audited and delinquent taxpayers receive IRS publications explaining the audit and collection processes, listing some examples of specific taxpayer rights, explaining the way to voice complaints, and describing the program for resolving problems in the Problem Resolution Office. The Problem Resolution Office is further publicized through newspapers, television and radio spots, tax practitioner newsletters, posters, telephone directory listings, and in the tax form packages provided to taxpayers.

Internal Security also advertises its availability to taxpayers through posters located in IRS offices. In addition, IRS' Taxpayer Service Division has toll free numbers taxpayers can use to phone in complaints. Apart from complaining directly to IRS, taxpayers may also complain to higher echelon Administration officials or to their congressional representatives.

Operating divisions' handling of complaints

IRS attempts to handle complaints first through its normal operating procedures. This means that, usually, the complaint is handled by the operating division. For example, a taxpayer who complains about an examiner's action during an audit can first go to the examiner's group manager. The group manager is responsible for resolving the dispute and initiating any personnel action against the examiner that may be warranted. If a taxpayer is not satisfied with the way the complaint was handled by the division and continues to complain, the problem is referred to the Problem Resolution Office. This referral can be done by either the taxpayer or the operating division.

IRS does not maintain statistics on the number or type of problems handled within the operating divisions. We did not attempt to evaluate the feasibility of capturing this data, but, considering the number of contacts these divisions have with taxpayers, the task might be mammoth. An alternative might be for IRS to scientifically sample contacted taxpayers to determine how well those taxpayers believe their rights were safeguarded. As with any scientific sampling technique, there may be problems in obtaining candid responses. This, along with other advantages and disadvantages, should be fully considered before such a requirement is adopted.

Problem Resolution Office handling of complaints

The Problem Resolution Office was established nationwide in 1977 to (1) give the taxpayer someone to turn to if the system fails to solve the problem, (2) assure that the problem is not lost or overlooked, and (3) identify organizational, procedural, and systemic problems so that corrective action can be taken. Once the problem or complaint reaches the Problem Resolution Office, it is controlled. Once controlled, IRS attempts to notify the affected taxpayer within a week to let the taxpayer know that IRS is looking into the problem. IRS' goal is to try to resolve such controlled complaints in 30 days. The problems, however, are normally sent back to the operating division for resolution. The Problem Resolution Office serves as a mechanism to monitor actions taken by the divisions to ensure that the complaints are considered and resolved in a timely manner. The Problem Resolution Officer

can refer cases to higher authorities if he or she feels the operating division did not satisfactorily resolve the problem.

According to statistics developed by the Problem Resolution Office, 313,000 taxpayer complaints were referred to it in fiscal year 1981--an increase of about 40 percent over the number of complaints in 1980. About 318,000 complaints were closed in fiscal year 1981 compared to 211,000 closed in 1980. The two largest categories of complaints dealt with delays in either IRS issuing a refund or the service centers responding to a taxpayer. These two areas accounted for 23 percent of all complaints.

This statistical information developed by the Program Resolution Office is not as useful as it could be and does not completely reflect the extent of the complaints on violations of taxpayer rights. IRS does not maintain statistics on how the complaints were resolved. For example, IRS does not record whether the complaint identified a valid IRS problem or whether the complaint was not IRS' fault. Therefore, IRS cannot systematically identify valid problem areas which may need management's attention.

Attempts are made by Problem Resolution Officers in each district to identify systemic problems. But this is not done scientifically; rather, it is up to the individual officer to determine trends on the basis of his or her awareness of the type of complaints received and the resolution.

In addition, IRS records and tracks complaints only for the primary issue involved. IRS officials informed us that complaints about tax issues or procedures are considered primary issues. Therefore, if a complaint was received which dealt with both a tax issue and an employee behavior problem, only the tax issue would be recorded and tracked. During our recent limited review of IRS' procedures and practices for safeguarding taxpayer rights, we found a few cases which were recorded and tracked for a tax issue that also included a complaint about employee behavior. Thus, recording and tracking for only the primary issue may account for the fact that only 181 of the complaints closed in fiscal year 1981 were recorded as involving discourteous service by an IRS employee. As a result, neither we nor IRS know how many complaints of taxpayer abuse were actually referred to the Problem Resolution Office.

We explored with IRS the feasibility of gathering additional information on how complaints were resolved and the number of complaints that involved IRS employee behavior. IRS officials expressed concern about the cost of such a system and the possible problems that may arise by having an outside organization track the resolution of complaints that are local management's responsibility and may involve adverse personnel actions. While IRS officials had no quantitative data to support their concerns, we believe those concerns merit consideration.

Given the fact that the current statistical information system does not provide a complete picture of alleged violations of

taxpayer rights and considering the concerns IRS raised about gathering such information, we believe IRS needs to fully explore all the advantages and disadvantages of gathering the information; document its findings and conclusions; and, to the extent possible, support the conclusions with quantitative data.

Internal Security investigates
allegations of serious IRS
employee misconduct

IRS' Internal Security Division is responsible for administering programs to protect the integrity of IRS. To carry out this responsibility, Internal Security conducts background investigations of current and prospective employees, performs internal control tests to identify procedural weaknesses and possible integrity violations, and makes presentations to IRS employees on their conduct responsibilities and the consequences of not meeting those responsibilities through an integrity awareness program. However, its major efforts in safeguarding taxpayer rights are in investigating allegations of serious employee misconduct. Such allegations may come from taxpayer complaints; referrals by other Government agencies, IRS divisions, or employees; or from self-initiated integrity investigation projects.

During fiscal years 1979 through 1981, Internal Security expended about 28,000 staff days investigating 1,687 cases of alleged employee misconduct. As a result of these investigations, 244 employees were separated from IRS, 431 were suspended or reprimanded, and 113 were convicted for criminal activities. Data is not readily available as to how many of the 1,687 cases

involved taxpayer rights issues. However, our review of Internal Security's management information reports covering certain fiscal year 1978 through 1980 employee investigations (see attachment for a statistical summary) shows that Internal Security investigated many complaints of extortion, bribery, conflicts of interest, and disclosure of tax information by IRS employees and that these investigations frequently resulted in the prosecution of, and/or adverse personnel action being taken against, IRS employees.

Furthermore, on the basis of our review of Internal Security operations completed in January 1979 1/ and our recent limited review of 33 judgmentally selected investigative case files in IRS' Midwest and Western Regions, we believe that Internal Security investigations are generally of a high quality and that case dispositions are generally reasonable in light of the evidence developed.

Although taxpayers can complain directly to Internal Security, some misconduct allegations also come from IRS managers and employees. IRS managers and employees are made aware of their responsibilities to report certain types of misconduct cases to Internal Security through the IRS handbook on employee responsibilities and conduct and Internal Security's Integrity Awareness Program. During fiscal year 1980 and 1981, Internal

1/"IRS Inspection Service Functions: Management Can Further Enhance Their Usefulness" (GGD-78-91, Jan. 30, 1979).

Security made 1,821 integrity awareness presentations to about 47,000 employees.

Generally, supervisors and managers are expected to handle employee problems of an administrative nature such as not following prescribed procedures or treating taxpayers discourteously, while Internal Security handles the more serious cases such as extortion, bribery, and conflicts of interest. Also, if after initial evaluation of an allegation, Internal Security determines that the employee misconduct does not warrant an Internal Security investigation, the facts of the case will be sent to IRS management for any needed administrative action.

In addition to investigating allegations reported to it, Internal Security does some searching on its own. During fiscal years 1980 and 1981, Internal Security spent about 6,600 staff days on integrity projects to assess the extent of criminal conduct occurring due to internal control weaknesses or through circumvention of controls. Internal Security identified 281 cases requiring investigations. For example, in one project Internal Security identified an employee who was selling confidential tax information. After a full investigation the employee was dismissed and prosecuted. The employee was sentenced to 1 year in prison and fined \$1,000.

Internal Audit also works closely with Internal Security in developing and implementing a preventive program to review internal controls to determine if material fraud exists and to

evaluate the effectiveness of these controls in deterring and detecting material fraud. The audits concentrate on IRS programs determined to be most susceptible to breakdown in control and breaches of integrity. In some cases, these audits directly impact on the adequacy of IRS' controls to safeguard taxpayer rights. For example, Internal Audit has looked at IRS procedures for

- collecting and depositing delinquent taxes and securing delinquent tax returns,
- suspending accounts from active collection activity,
- determining and assessing tax deficiencies, and
- protecting tax information from disclosure.

EFFECTS OF SELECTED
PROVISIONS OF THE 1976
TAX REFORM ACT

I would now like to discuss our observations on two of the many provisions of the Tax Reform Act of 1976 that deal with safeguarding taxpayer rights. We recently testified before this subcommittee on the disclosure provisions of the act. Today I will discuss the administrative summons and the return preparer penalty provisions.

Let me preface my statement by saying that, as with our other work in the area of tax administration, we looked at both the effects of these provisions on IRS and tax administration in general, as well as their effects on taxpayer rights.

The summons provisions of the 1976 Tax Reform Act protect taxpayer rights but also interfere with IRS' investigative activities

At this point, I would like to discuss the third-party recordkeeper summons provisions of the Internal Revenue Code which afford taxpayers certain protections but also unnecessarily interfere with IRS' investigative activities.

Most IRS officials responsible for examining tax returns, collecting taxes, or investigating a taxpayer's failure to comply with the tax laws are authorized to summon a taxpayer or a third-party recordkeeper--such as the taxpayer's accountant or banker--to produce books, papers, records or other data. Before March 1, 1977, IRS was not required to notify a taxpayer when it issued a summons to a third-party recordkeeper. Thus, taxpayers sometimes were unaware of IRS' investigations into their financial affairs.

The Congress, through the Tax Reform Act of 1976, required that IRS notify the affected taxpayer after issuing a summons to a third-party recordkeeper. The taxpayer then has 14 days within which to stay compliance, that is, to order the third party to not comply with the summons. If IRS initiates court action to enforce a stayed summons, the taxpayer can intervene in the court proceeding.

Both Department of Justice and IRS officials contend that the current stay procedure often is used as a delaying tactic

by investigative targets whose sole intent is to disrupt investigations. In a March 1979 report, 1/ we pointed out that IRS was not collecting the statistical data needed to support that contention. Nevertheless, on the basis of the limited data we had collected, we recommended that the Congress consider revising the summons provisions to prevent abuses while retaining essential taxpayer safeguards. Concurrently, we recommended that IRS develop a summons reporting system to collect the data required to convince the Congress of the need for a legislative change.

IRS responded to our recommendation by initiating efforts to develop and implement a computerized summons reporting system. As an interim measure, IRS' Western Region did a detailed analysis of summons problems. It disclosed that taxpayers stayed compliance in relatively few instances. Only 240, or 8.5 percent, of the 2,823 summonses issued by the region's criminal investigators were stayed during the first 6 months of fiscal year 1979. Significantly, however, the region found that tax protesters and individuals involved in illegal activities, including drug traffickers, were the persons most likely to stay compliance. A total of 304, or 75 percent, of the 411 summonses pending enforcement at June 30, 1979, involved such persons. The region also noted that, during fiscal year 1978, taxpayers stayed compliance in 691 instances but actually contested summonses in court in only 82 instances, or about 12 percent of the time. This indicates that

1/"Disclosure And Summons Provisions Of 1976 Tax Reform Act-- Privacy Gains With Unknown Law Enforcement Effects" (GGD-78-110, Mar. 12, 1979).

many individuals who stay compliance seek only to delay an on-going criminal tax investigation.

Despite these indications, the extent to which the summons provisions are used nationwide to impede IRS investigations is unknown because IRS still has not collected comprehensive data on the problem. Although its computerized summons reporting system is now in place, the data being generated is incomplete and inaccurate, according to IRS officials. The officials noted, however, that efforts were being made to perfect reported data and to correct deficiencies in the system. They further stated that this was being done because IRS still is experiencing serious problems with the summons provisions.

Recently, we sought to develop data on the extent and severity of those problems in five IRS district offices. We found, however, that the districts did not have readily available records of summonses issued to third-party recordkeepers and, as a result, we were unable to define universes from which to select representative samples. We, therefore, limited the scope of our work to obtaining readily available data on and examples of problems IRS has experienced with the summons provisions.

In Boston, the Assistant Chief of the Criminal Investigation Division sought to gather data for us on summonses stayed by taxpayers during fiscal year 1980. According to the Assistant Chief, 693 third-party recordkeeper summonses were issued during fiscal year 1980. Of these, 59, or 9 percent were stayed. Subsequently, the Justice Department sought district court enforcement of 54 of the 59 stayed summonses. As of November 1981, 50

of the 54 stays had been ruled on by district courts. All 50 were decided in favor of the Government. In 40, or 80 percent, of the cases, the taxpayer did not appear in court.

In Dallas, we were able to determine that the district issued 562 third-party recordkeeper summonses in fiscal year 1980. Of these, 68, or 12 percent, were stayed. When we completed our work, 58 of the 68 stays had been settled via district court action. In 50, or 86 percent, of the 58 cases, the taxpayer did not appear in court.

The following examples further indicate the problems IRS has encountered with the summons provisions:

- IRS issued a summons to a bank with respect to a taxpayer under investigation for unreported income. The taxpayer stayed compliance in October 1980. The Justice Department subsequently obtained a June 1981 hearing in district court on summons enforcement. The taxpayer did not appear for the hearing. The court thus granted enforcement of the summons. Nevertheless, IRS' investigation had been delayed for 8 months.
- IRS issued several third-party recordkeeper summonses with respect to a farmer's tax liability in August 1980. In April 1981, the farmer's attorney indicated to IRS that he would not seek to contest two of the five summonses in court.
- IRS issued three summonses to banks during its investigation of an individual whose business involved selling family trusts. It took the Justice Department an average of 1 year to obtain a district court hearing on each summons. The taxpayer did not appear for any of the hearings and each summons then was enforced. Yet the taxpayer had successfully delayed IRS' investigation.

Although the full extent to which IRS' investigative efforts are thwarted by misuse of the summons provisions remains unknown, there are some statistics and some specific case examples of serious problems. These isolated statistics and examples provide

no basis for removal of present taxpayer safeguards. There is, however, a legislative remedy which would at least partially resolve IRS' problems with the summons provisions while retaining essential taxpayer safeguards. Specifically, the law could be amended to specify that taxpayers must initiate court action to stay compliance of third-party recordkeeper summonses. H.R. 1501, which currently is under consideration by this subcommittee, would accomplish such a revision.

IRS still would be required to notify the affected taxpayer when it issues a summons to a third-party recordkeeper. Likewise, the affected taxpayer would still have an opportunity to stay compliance with the summons. However, the bill would require the taxpayer to file a motion to quash the summons in the local district court, rather than allowing him or her to stay compliance without a court action. This is similar to the procedure set forth in the Right to Financial Privacy Act of 1978 which addresses Federal agencies' access to customers' records maintained by financial institutions and establishes procedures to safeguard the privacy of such records. Accordingly, we support enactment of H.R. 1501.

Present status of IRS'
administration of tax
preparer penalties

The 1976 Tax Reform Act afforded taxpayers some safeguards against negligent and/or fraudulent paid return preparers. Among other things, the act authorized IRS to assess penalties--ranging from \$5 to \$500--against paid preparers who (1) do not identify themselves or only partially identify themselves on tax returns,

(2) do not keep adequate records, (3) understate a taxpayer's tax liability, and/or (4) negotiate a taxpayer's refund check. Over 200,000 paid preparers are subject to these provisions.

At the request of this subcommittee and the Joint Committee on Taxation, we are currently evaluating the extent to which IRS has been successful in implementing the Tax Reform Act's paid preparer provisions. Although we have not yet completed our work, preliminary analyses indicate that IRS has achieved some success in dealing with preparers who do not fully identify themselves on returns. On the other hand, IRS has been less successful in dealing with preparers who do not identify themselves at all on returns and/or do not keep adequate records. Further, the extent to which IRS has been successful in detecting and deterring preparers who commit serious conduct violations is unknown. IRS is not collecting and/or not analyzing the data it needs to assess program effectiveness.

Through educational efforts and assessment of penalties, IRS has been able to substantially reduce the number of paid preparers who provide only partial identification information on returns. In calendar year 1979, IRS assessed 33,937 penalties against preparers who did not fully identify themselves. Such preparers may have omitted their names, social security numbers, and/or employer identification numbers. In 1981, however, IRS assessed only 3,241 such penalties primarily because preparers had become more aware of the need to fully identify themselves on returns. Thus, IRS has been successful in getting a segment of the paid

preparer population--those who already were providing partial identification--to better comply with the law.

On the other hand, IRS has not achieved such dramatic success with respect to preparers who provide no identification on returns and/or do not keep required records. In this regard, rather than set up a costly new compliance program directed at paid preparers, IRS decided to rely on its normal enforcement approaches to detect non-disclosure violations. As a result, individuals who commit these violations generally will not be detected unless returns they prepare are selected for examination. Presently, IRS examines less than 2 percent of returns filed each year. However, even if such returns are selected for examination, these preparers may not be detected unless they or their taxpayer clients respond to examiners' probing questions concerning who prepared the return, whether it was prepared for a fee, and whether required records have been kept.

Despite this somewhat limited compliance program approach, IRS assessed 13,088 penalties against preparers for non-disclosure and recordkeeping violations in 1980, and, in 1981, 11,773 such penalties were assessed. Nevertheless, a question remains as to whether IRS is in fact detecting and penalizing a sufficient number of preparers who commit these violations.

With respect to preparers who understate taxpayers' tax liabilities, IRS' efforts have been hampered by inadequate guidelines. For example, IRS has not specifically defined the difference between the \$100 negligent or intentional misconduct penalty and the \$500 willful misconduct penalty. Further, it was not

until 1980 that IRS provided examiners with some specific guidelines on whether penalties were to be asserted for isolated errors. Also lacking until 1980 was guidance on the means through which to determine whether preparer errors were material in nature and whether preparer errors were attributable to tax law complexity rather than misconduct. As a result, no trends have yet surfaced with regard to these penalties.

Concerning penalties asserted against preparers for endorsing or negotiating a taxpayer's refund check, IRS' enforcement efforts have been extremely inconsistent. One IRS district--Louisville--has accounted for 3,445 or 66 percent, of the 5,242 refund check penalties asserted nationwide during 1980 and 1981. This variance occurred primarily because the Louisville district adopted an aggressive approach to identifying refund check violations. Instead of relying solely on questions put to preparers during examinations, the district used service center generated lists to identify potential targets. District examiners then visited the offices of selected preparers and asked pointed questions. By doing so, the examiners were very successful in detecting and penalizing violators.

Although service center generated lists were available to all IRS districts, only the Louisville district took advantage of them. According to IRS officials, there is no reason to believe that refund check violations are unique to the Louisville district. Therefore, we question whether IRS has detected and penalized a sufficient number of refund check violators nationwide.

In sum, the extent to which IRS has been effective in detecting and deterring problem preparers is unknown. Besides problems relating to limited examination coverage and inadequate guidelines, IRS has not sought to collect or analyze the data needed to assess program effectiveness. Of particular concern is the fact that IRS lacks data on repeat offenders. Without data on repeat offenders, IRS will be hard-pressed to know whether it is making effective use of a key provision of the 1976 Tax Reform Act that authorizes IRS to remove a preparer from practice when such removal is appropriately justified. During 1977 through 1981, IRS invoked that provision on three occasions.

In our view, a more systematic approach to the preparer penalty program is needed. We plan to issue a report containing specific recommendations on this matter later this year.

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In summary, Mr. Chairman, our work over the past several years at IRS has disclosed neither flagrant abuses of taxpayer rights nor indications of systematic attempts to violate such rights. We attribute this in large part to the success of IRS' management control system. That system includes policies, procedures, and controls which provide reasonable assurance that abuses of taxpayer rights are minimized in number and that those abuses which do occur are detected and dealt with in an acceptable manner.

However, considering that IRS has about 85,000 employees, about 49 million contacts with taxpayers a year, and that

individual judgment is required when IRS deals with taxpayers, there can never be 100 percent assurance that a violation of taxpayer rights will not occur. Notwithstanding, we believe that the management system we have discussed today is designed to keep instances of such abuse to a minimum. This is not to say that individual aspects of the system cannot be strengthened.

Even though the system may be working, the fact that IRS does not know the number of complaints it receives about violations of taxpayer rights or how satisfied taxpayers are with treatment they receive from IRS does leave a void. I have discussed two possible approaches to capture this information--the statistical surveying of taxpayers to determine their satisfaction with IRS' treatment and expansion of the information developed by the Problem Resolution Office. Both approaches have advantages and disadvantages which have not yet been explored. Therefore, if the subcommittee sees a need to fill this void, we suggest that IRS be tasked to look into the feasibility and desirability of these two approaches. IRS should document its findings and conclusions and, to the extent possible, support the conclusions with quantitative data.

Concerning the summons provisions of the 1976 Tax Reform Act, we see a need for a legislative change. While the problems IRS has encountered with the provisions have not been fully documented, there is sufficient information available to support the need for legislative action. Clearly, some taxpayers are using the provisions solely for the purpose of delaying and/or thwarting

IRS investigations. H.R.1501 would prevent such abuses but, importantly, would also preserve taxpayer rights in summons matters. Accordingly, we support enactment of that bill.

With respect to the preparer penalty sections of the Tax Reform Act, we see a need for various actions on IRS' part to improve administration. We plan to specify those actions in a report later this year.

This concludes my prepared statement. I would be pleased to answer any questions.

Summary of Investigations of Selected
Alleged Employee Violations
For Fiscal Years 1978 Through 1980

Type of alleged violation	No. of incidences investigated	Adverse adjudications		
		Adverse personnel action	Resigned prior to adjudication	Accepted for prosecution
Fraudulent claims	590	105	73	45
Embezzlement	186	13	7	25
Theft of Gov't property	166	27	23	15
Conflict of interest	289	37	9	2
Computer fraud	69	13	3	1
Extortion	189	20	8	4
Bribes and gratuities	177	9	5	10
Disclosure	<u>172</u>	<u>20</u>	<u>8</u>	<u>4</u>
Total	<u>1,838</u>	<u>244</u>	<u>136</u>	<u>106</u>